

No. 83

**In the
Supreme Court of the United States**

OCTOBER TERM, 1961

**HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of
the Estate of Max L. Druxman, Bankrupt, *Petitioner*,**
vs.

**R. C. GRANQUIST, District Director of the Internal
Revenue Service, *Respondent*.**

and

**RICHARD D. HARRIS, Trustee for Alaska Telephone
Corporation, *Petitioner*,**
vs.

UNITED STATES OF AMERICA, *Respondent*,

**UPON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE NINTH CIRCUIT**

BRIEF OF PETITIONERS

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OPINIONS BELOW

A. *Simonson v. Granquist*:

The Referee's Findings, Conclusions and Order and the Order of the District Court for the District of Oregon, are unreported, but are fully set forth in the Transcript of Record (S.R. 7, 22 and 27). All references to the *Simonson* record are herein denoted as "S.R." The opinion of the United States Court of Appeals for the Ninth Circuit (S.R. 34-37) is reported at 287 F.2d 489.

B. *Harris v. United States of America*:

The Referee's Opinion, Findings of Fact, Conclusions of Law, and Orders, as entered by the District Court for the Western District of Washington, are unreported.

ed, but are fully set forth in the Transcript of Record (H.R. 33-46, 54-57). All references to the *Harris* record are herein denoted as "H.R." The opinion of the United States Court of Appeals for the Ninth Circuit (H.R. 65-66) is reported at 287 F.2d 491.

JURISDICTION

In both cases, the judgment of the court of appeals was entered on February 1, 1961 (S.R. 37; H.R. 66). A petition for rehearing was denied on March 13, 1961, (H.R. 67). The petition for writ of certiorari was filed on April 22, 1961, and was granted on June 5, 1961 (H.R. 67). 6 L. Ed.2d 854. The jurisdiction of this Court rests upon 28 U.S.C. §1254(1) and 11 U.S.C. §47.

QUESTIONS PRESENTED

A. In *Simonson v. Granquist* and *Harris v. United States of America*:

Is an addition to a federal tax imposed as a penalty by statute, and which became a secured claim against the property of the taxpayer and for which a lien arose and notices of lien were filed prior to the filing of a petition in bankruptcy or reorganization, properly allowable as a secured claim against the debtor's estate, or is such claim disallowed by the operation of Section 57(j) of the Bankruptcy Act?

B. In *Simonson v. Granquist* alone:

Is the trustee in bankruptcy a "judgment creditor" within the purview of Section 6323(a) of the Internal Revenue Code of 1954 so that the United States does not have a valid tax lien as against the trustee in bank-

ruptcy where its tax assessments and the demand for payment were made prior to the filing of the petition in bankruptcy, but notice of the tax lien was not filed until after the petition in bankruptcy had been filed?

STATUTES INVOLVED

A. In *Simonson v. Granquist* and *Harris v. United States of America*:

Sections 17, 57(j) and 67(b) of the Bankruptcy Act (11 U.S.C. §§35, 93(j) and 107(b)) are involved, as is Section 6321 of the Internal Revenue Code of 1954 (26 U.S.C. §6321). These are set forth in the appendix, *infra*, pp. 27, 28, 31.

B. In *Simonson v. Granquist* alone:

Sections 64(a) and 70(c) of the Bankruptcy Act (11 U.S.C. §§104(a) and 110(c)) are involved, as is Section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. §6323). These are set forth in the appendix, *infra*, pp. 28, 31, 32.

STATEMENT OF THE CASES

A. *Simonson v. Granquist*:

Upon the trustee's application, the referee ruled upon the allowance of certain secured claims of the United States for penalties and post-bankruptcy interest. The facts are not in dispute and, as found by the referee, may be stated as follows (S.R. 7-8):

The bankrupt was in the business of a small retail jeweler and the trustee was able to realize more than \$8,000 upon liquidation of the business assets. This sum was sufficient to pay all tax claims and expenses of administration (S.R. 7).

The Director of Internal Revenue filed various claims in the bankruptcy proceedings for income, employment and excise taxes accruing prior to bankruptcy and owing by the bankrupt. The trustee paid \$4,932.41 of taxes owing but disputed liability for \$1,442.41 of penalties and \$182.49 of post-bankruptcy interest (S.R. 6-8).

The taxes and penalties involved were assessed against Druxman on September 6, 1957, and a statement of tax due and demand for payment was issued ten days later. Druxman filed a voluntary petition in bankruptcy on October 18, 1957. The notice of tax lien was filed by the District Director of Internal Revenue on October 31, 1957 (S.R. 7).

The United States asserted its claim for taxes, penalties and interest as a secured creditor by virtue of its pre-existing lien and not as a priority unsecured creditor (S.R. 8).

The referee held that the federal tax lien was perfected against the trustee where the tax had been assessed and demand for payment had been made upon the taxpayer prior to bankruptcy although notice of the lien was not filed until after the filing of the petition in bankruptcy (S.R. 9-11). The referee also held that Section 57(j) of the Bankruptcy Act applies only to unsecured claims and does not disallow the payment of penalties on a tax lien (S.R. 11-13). Finally, the referee held that the United States was not entitled to post-bankruptcy interest (S.R. 13-21).

The trustee petitioned the district court for review of the referee's order insofar as it allowed the United

States penalties included in its claim based on a federal tax lien (S.R. 28-29). The district court affirmed the order of the referee (S.R. 27-28). The trustee then appealed to the United States Court of Appeals for the Ninth Circuit, which court affirmed the order of the district court (S.R. 34-37). Petitioner then petitioned this court for certiorari, which was granted on June 5, 1961 (S.R. 67).

B. *Harris v. United States of America:*

The Alaska Telephone Corporation, the taxpayer and debtor herein, filed a petition for a reorganization under Chapter X of the Bankruptcy Act, as amended, as of September 30, 1955. The filing of this petition was approved by the district court on November 21, 1955 (H.R. 33-34).

The United States filed proofs of claims for unpaid taxes with the trustee. Included in its claims are unpaid F.I.C.A. and telephone and telegraph excise taxes for 1952 and 1953 in the amount of \$56,382.93, pre-petition interest in the amount of \$1,056.28, post-petition interest, and penalties imposed on such unpaid taxes in the amount of \$7,714.72, for which the United States obtained liens in 1953 and filed notices of its liens in 1953 and 1954, prior to the time the debtor filed its petition in reorganization. Also, included in its claims are \$182.86 of unpaid federal unemployment taxes for which a lien did not arise until 1956 and for which the United States did not seek to obtain interest or penalties (H.R. 13-20, 39-40).

Prior to the filing of the petition in reorganization

the taxpayer submitted an offer in compromise of \$40,000 to settle the taxes involved and deposited that amount with the District Director of Internal Revenue between June 7, 1954, and August 19, 1955. Upon the filing of the petition for a reorganization the offer was withdrawn and the money was returned to the trustee on January 17, 1956 (H.R. 40).

A plan of reorganization was filed which, as amended, was submitted to the district court for approval which provided, among other things, for payment of \$57,000 in full settlement of the debtor's federal tax liabilities (H.R. 23-29, 38). The sum \$57,000 has been paid by the trustee to the District Director and is being held in a suspense account pending the outcome of these proceedings (H.R. 40). Notice was served upon the Secretary of the Treasury to accept or reject the amended plan (H.R. 32-33), and on December 26, 1958, the Acting Secretary of the Treasury, Julian A. Baird, filed a notice of rejection of the trustee's plan of reorganization with the clerk of the district court.

Following the happening of the above-mentioned matters the trustee filed objections to the claims of the United States (H.R. 13-20), which objections were heard before the referee in bankruptcy who was also designated as a special master. The referee held that the Secretary of the Treasury failed to reject properly the proposed plan of reorganization and therefore was conclusively presumed to have accepted it, and that the claims of the United States were fully satisfied by payment of the \$57,000. The referee also held that the trustee was entitled to a credit against the claim of the

United States for interest in the amount of \$3,863.81 on the \$40,000 deposited by the debtor under the offer in compromise. Finally, the referee held that the United States was not entitled to obtain assessed or other pre-petition or post-petition interest or penalties on its secured claims (H.R. 34-37, 40, 41-45, 46).

Upon a petition for review filed by the United States (H.R. 4-10, 47-53), the district court modified the order of the referee and held that the United States had properly rejected the amended plan of reorganization, that the claims of the United States should not be reduced for interest in moneys held by it pursuant to an offer in compromise, and that the United States was entitled to pre-petition interest on the principal of all taxes owed by the debtor. However, the district court affirmed the order of the referee insofar as it disallowed the recovery of penalties and post-petition interest on the secured claims of the United States (H.R. 55-57). The United States of America then appealed to the United States Court of Appeals for the Ninth Circuit on the issue of penalties but not on the issue of post-petition interest. The circuit court reversed and remanded the order of the district court (H.R. 65-66). Petitioner then petitioned this Court for certiorari, which was granted on June 5, 1961 (H.R. 67).

SUMMARY OF ARGUMENT

I. Applicable to *Simonson v. Granquist* and *Harris v. United States of America*.

The specific provisions of Section 57(j) of the Bankruptcy Act prohibit the allowance of tax penalties in bankruptcy proceedings, and this prohibition applies

to liened as well as unliened penalties. This is so because by all applicable rules of statutory construction, the general lien allowances of Section 67(b) of the Bankruptcy Act must be read in light of and so as to give full effect to Section 57(j). Also, it is clear that the court of bankruptcy has jurisdiction to go behind general tax liens to determine which portion thereof consists of a forbidden penalty, and that not to do so is to fail to give full force to Section 57(j), thus contradicting the policy of the Bankruptcy Act by shifting the burden of the tax penalty from the bankrupt to the unsecured general creditors. This shift is particularly inequitable since Section 17 of the Bankruptcy Act operates to prevent discharge of the tax penalty in bankruptcy so that the Government penalty claim continues to exist until actually paid. Thus the holding of the Circuit Court of Appeals that a liened penalty claim is not subject to the policy of Section 57(j) is error and should be overruled.

II. Applicable to *Simonson v. Grahquist alone*:

The plain language of Section 70(c) of the Bankruptcy Act gives the trustee in bankruptcy the status of a judgment creditor, and Section 6323(a) of the Internal Revenue Code of 1954 provides that a tax lien "shall not be valid as against any . . . judgment creditor until notice thereof has been filed . . ." Holdings of various circuit courts that a trustee in bankruptcy cannot claim his judgment creditor status *vis a vis* unrecorded federal tax liens are inconsistent with basic rules of statutory construction, and undercut the consistent pattern of the Bankruptcy Act and the clearly

expressed Congressional intent behind Section 70(c). Also, the effect of these holdings is to deprive employees of the bankrupt, and those who have attempted to protect the property of the bankrupt, of the priorities expressly given them over such unrecorded federal tax liens by Section 64(a) of the Bankruptcy Act.

ARGUMENT

I. Applicable to both *Simonson v. Granquist* and *Harris v. United States of America*:

The specific provisions of Section 57(j) of the Bankruptcy Act prohibit the allowance of tax penalties in bankruptcy proceedings, and this prohibition applies to liened as well as to unliened penalties.

Section 57(j) of the Bankruptcy Act expressly forbids the assertion of penalties in a bankruptcy proceeding:

“Debts owing to the United States or to any state or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.”

It is perfectly clear that such penalties cannot be asserted if no valid lien therefor has been established. 3 Collier on Bankruptcy (14th Ed., 1956) 301. *New York v. Jersawit*, 263 U.S. 493, 68 L.Ed. 405 (1924).

However, the government asserts, and the court of appeals in the instant cases held, that 57(j) does not apply when the lien for the penalty claimed has been

filed prior to the filing of the petition in bankruptcy, because Section 67(b) gives general support to tax liens in this situation. *Simonson v. Granquist* (9th C.A., 1961) 287 F.2d 489. *Harris v. United States* (9th C.A., 1961) 287 F.2d 491. The circuit court here elected to follow, without elucidation, its earlier opinion in *In re Knox-Powell-Stockton Co.* (9th C.A., 1939) 100 F.2d 979. Two other circuits have made similar rulings. *United States v. Mighell* (10th C.A., 1959) 273 F.2d 682; *Grimland v. United States* (10th C.A., 1953) 206 F.2d 599; *Commonwealth of Kentucky ex rel. Unemployment Compensation Commission v. Farmers Bank and Trust Co.* (6th C.A., 1943) 139 F.2d 266.

However, in another line of recent circuit court decisions, the courts refused to stop their analysis with an assertion of an alleged conflict between Sections 67(b) and 57(j), and in well-reasoned opinions demonstrated that 67(b) must be read in light of the specific prohibitions of 57(j).

“Sec. 67, sub. b merely exempts certain statutory liens, including tax liens, from the provisions concerning preferences in Sec. 60. Nothing in the language of Sec. 67, sub. b justifies the conclusion that it is intended to except liened penalties from the prohibition of Sec. 57, sub. j. Both sections are entitled to be given effect.” *United States v. Harrington* (4th C.A., 1959) 269 F.2d 719.

See also *United States v. Phillips* (5th C.A., 1959) 267 F.2d 374. And see *In re Burch* (D.C. Kan., 1948) 89 F. Supp. 249; *In re Hankey Baking Co.* (D.C. W.D. Pa., 1959) 125 F.Supp. 673; *In re Lykens Hosiery Mills, Inc.*, (D.C. S.D. N.Y., 1956) 141 F.Supp. 895; *In re*

Parchem (D.C. Minn., 1958) 166 F.Supp. 724. The *Phillips* court quoted with approval the dissent of Judge Simon from the decision in *Commonwealth of Kentucky, supra*:

"I agree with the opinion of the majority that the exaction imposed by Kentucky law for failure to pay past-due unemployment contributions constitutes a penalty. I am unable to agree that [57(j)] does not come into operation because the Bankruptcy Act preserves liens valid under state law, and this with all due respect for the views of my associates and the opinion of the Circuit Court of Appeals for the Ninth Circuit in the Knox-Powell-Stockton Co. case.

"A lien is a charge upon property for the payment or discharge of a debt. It is therefore dependent upon the existence, the amount of, and the provability of the debt. If the debt has been paid or otherwise expunged as for fraud or by set-off, the lien is extinguished. An inchoate lien does not ripen into security until a debt comes into existence. In the case of private liens, it may be impermissible to prove a debt because of the statute of frauds or the running of the statute of limitations.

"* * * I am unable to see how a lien, however valid it may be under state law, will breathe life into an unprovable debt in the face of [57(j)] which deals expressly with debts owing to any state or subdivision. The two provisions of the Bankruptcy Act are not irreconcilable. The tax lien is preserved to the extent that it does not include a penalty and the tax debt, other than the amount of the penalty, is provable. To the extent that the debt is not provable in bankruptcy, the lien ceases for all practical purposes to exist * * *." 139 F.2d 267.

1. *The specific prohibition of Section 57(j) applies because by all rules of statutory construction the general lien allowances of Section 67(b) must be read in light of and so as to give full effect to Section 57(j).*

This reading of the specific disallowance of Section 57(j) as being consistent with the more general protective provision of Section 67(b) is consonant with the basic principles of statutory construction. Where possible, it is the duty of the courts, in the construction of statutes, to adopt the construction of a statutory provision which harmonizes and reconciles it with other statutory provisions. 50 Am. Jur. 367, Statutes § 363, and footnote 12 where extensive case authority is cited. Specific terms covering a single subject matter will prevail over general language which otherwise might be controlling, *Baltimore National Bank v. State Tax Commission*, 297 U.S. 209, 80 L.Ed. 586 (1936); *Kepner v. United States*, 195 U.S. 100, 49 L.Ed. 114 (1904); *D. Ginsberg & Sons v. Popkin*, 285 U.S. 204, 76 L.Ed. 704 (1932); *Re East River Towing Company*, 266 U.S. 355, 69 L.Ed. 324 (1924). Thus to hold that Section 57(j) applies only to unliened penalties severely limits the operation of that section, and allows the general wording of Section 67(b) to take precedence. It is much more reasonable to allow 57(j) to control whenever a penalty, liened or unliened, is attempted to be claimed.

2. *The prohibition of Section 57(j) can be applied to liened claims because it is clear that the court of bankruptcy has jurisdiction to go behind general tax liens to determine which portion thereof consists of a forbidden penalty.*

The jurisdiction of the court of bankruptcy to look behind liens, including even liens based on the judgments of other courts, is clear. *Pepper v. Litton*, 308 U.S. 295, 84 L.Ed. 281 (1939):

"Hence this court has held that a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence. *Lesser v. Gray*, 236 U.S. 70, 57 L.Ed. 471. And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry. As the merger of a claim into judgment does not change its nature so far as provability is concerned, *Boyn-ton v. Ball*, 121 U.S. 457, 30 L.Ed. 985, so the court may look behind the judgment to determine the essential nature of the liability for purposes of proof and allowance. *Wetmore v. Markoe*, 196 U.S. 68, 49 L.Ed. 390 * * *." *Ibid*, at 305-06, 288.

Thus, although a general "lien for taxes" including penalties may be created by the provisions of Section 6321 of the Internal Revenue Code, it is clearly within the jurisdiction of the court of bankruptcy to determine whether any portion of a general lien is based on a debt forbidden to be proved. As was held in *Phillips*:

"The statutory enactment that the amount of an unpaid tax shall be a lien is, we think, nothing but a shorthand provision creating a tax lien to secure the obligation of the unpaid tax. The penalty is an obligation of the defaulting taxpayer. The character of the obligation as a penalty is not changed, as we view the question, when it becomes a secured obligation. If the Government's claim against the bankrupt continues to be a penalty, and we think it did, and if the Government sustains no pecuniary

loss by the act, transaction or proceeding out of which the penalty arose, and it is not so contended, then we conclude that the amount of the penalty was properly excluded from the Government's claim as allowed." *Ibid.*, at 377.

This holding is perfectly consistent with the persuasive dictum of this Court in *Gardner v. New Jersey*, 329 U.S. 565, 91 L.Ed. 504 (1947):

"The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission v. Thompson*, 313 U.S. 132, 85 L.Ed. 1244 (1941). There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. [Section 57(j)] provides that debts owing a State as a 'penalty or forfeiture' shall not be allowed." *Ibid.*, at —.

3. *The prohibition of Section 57(j) should be applied because the failure to give full force thereto contravenes the policy of the Bankruptcy Act and in fact shifts the burden of the penalty from the bankrupt to the unsecured general creditors.*

The government, on the other hand, would read the explicit prohibition of Section 57(j) and the general provisions of Section 67(b) as if they had no relationship whatsoever. This is not only inconsistent with the logical construction of the Bankruptcy Act, but contravenes the policy consideration underlying Section 57(j). A penalty is still a penalty regardless of its being cloaked by a tax lien for the purpose of putting

additional weight behind the collection machinery of the Internal Revenue Service. To hold otherwise would operate unfairly to punish general creditors who contributed to the bankrupt's estate by enforcing a punishment directed at the bankrupt only and not at those dealing with him in good faith. *In re Burch* (D. Kan., 1948) 89 F.Supp. 249.

"The government collects its revenue and other claims, to an increasing extent, not from its taxpayers and those who enter into direct business relations with it or its various agencies, but from those who enter into business relations with taxpayers * * *." MacLachlan, *Improving the Law of Federal Liens and Priorities*, 1 B.C. Ind. and Com. L. Rev. 73 (1959). And see recent law review comments, all approving the results in *Phillips* and *Harrington*, based on the conclusion that to read 57(j) narrowly as the government here asks is to punish the creditors who actually contributed to the bankrupt's estate prior to bankruptcy while allowing recovery to the government of a mere fine or punishment which should be assessed against the bankrupt alone. 38 Tex. L. Rev. 800 (1960); 40 B.U. L. Rev. 136 (1960); 47 Minn. L. Rev. 1149 (1960).

4. *This effective transfer of the penalty to the unsecured general creditors is particularly inequitable because Section 17 of the Bankruptcy Act acts to prevent discharge of the penalty in bankruptcy so that the Government claim continues to exist until actually paid.*

Additional weight is given to the conclusion that the purpose of 57(j) is to avoid shifting punishment from

the bankrupt to the creditors, and that full force must be given to the section, by the provisions of Section 17 of the Bankruptcy Act (11 U.S.C. § 35):

“A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as * * * are due as a tax levied by the United States * * *.

It seems clear that, except when disallowed by such a specific section as 57(j), tax penalties will, under the language of Section 6321 of the Internal Revenue Code, be considered a part of the tax levied by the United States. Thus, while ordinary creditors' unsecured claims will be discharged in the bankruptcy action, the penalty owing the government will *not* be discharged and will still be alive and enforceable by the government after the proceedings. 1 Collier on Bankruptcy (14th Ed., 1956) §§ 17.05, 17.13. The language of *United States v. Mighell* (10th C.A., 1959) 273 F.2d 682, is expressly contra, but that was a logical result only when lien tax penalties were held provable in bankruptcy in spite of 57(j). Thus not only would allowance of lien tax penalties be, in actual effect, a transfer of punishment from the bankrupt to the general creditors, but such transfer is unnecessary to protect the existence of the Government's claim. The Internal Revenue Service's "bird-in-the-hand" philosophy of collection should not be allowed to run so far.

“We are reminded that legislation in aid of the collection of Government revenues should be liberally construed and applied. But we are charged with the duty to give effect to the purpose of [57(j)] which was designed to protect general

creditors against a reduction of their dividends from a bankrupt estate by reason of penalties or forfeitures owing by the bankrupt to the United States or one of the States. The judgment of the district court [disallowing liened penalties] is affirmed." *United States v. Phillips* (5th C.A., 1959) 267 F.2d 374, 378.

II. Applicable to *Simonson v. Granquist* alone:

*The plain language of Section 70(c) of the Bankruptcy Act gives the trustee in bankruptcy the status of a judgment creditor, and Section 6323(a) of the Internal Revenue Code of 1954 provides that a tax lien "shall not be valid as against any * * * judgment creditor until notice thereof has been filed * * *."*

Section 70(c) provides:

"The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

In spite of this language, the court below, following its decision in *United States v. England* (9th C.A., 1955) 226 F.2d 205, and the holdings in other circuits in *In re Fidelity Tube Corp.* (3rd C.A., 1960) 278 F.2d

776 (cert. denied, *sub nom*, *Borough of East Newark v. United States*, 5 L.Ed.2d 56 (1961)), and *Brust v. Sturr* (2d C.A., 1956) 237 F.2d 135, held that a trustee in bankruptcy could not claim the status of a judgment creditor in regard to unrecorded federal tax liens under Section 6323(a) of the Internal Revenue Code of 1954.

1. *These contrary holdings are inconsistent with basic rules of statutory construction:*

The cited holdings establish, in effect, two readings of Section 70(c); the plain meaning of that section is to define the trustee as a judgment creditor, but the cases hold this not to be so in regard to inchoate tax liens. As was said by Judge Kalodner in his exhaustive and persuasive dissent to *Fidelity Tube, supra*:

"The text writers are in accord with the view that a bankruptcy trustee is a 'judgment creditor' under Section [70(c)]: Collier on Bankruptcy (14th ed., 1958) Vol. 4, par. 70.49, pages 1710 *et seq.*; Remington on Bankruptcy, 1957 ed., Vol. 3, pages 557, 558, 559; Seligson, Creditors Rights (1957) 32 N.Y.U.L.R. 708, 31 J. of Natl. Assn. of Ref. 113." *Ibid*, at 785.

"In my view, there just cannot be two varieties of a 'judgment creditor' under separate federal statutes which relate to such creditors. A 'judgment creditor' cannot be 'fish' under one federal statute and 'fowl' under another. Nor does a bankruptcy trustee have a dual personality — that of a 'judgment creditor' in one room of the federal legislative structure and a total absence of it in another room of the same structure." *Ibid*, at 782.

Judge Hastie joined Judge Kalodner in this dissent.

Also, in a concurrence below in *Simonson*, 287 F.2d 489, 490-91, Judge Hamley expressed agreement with Judge Kalodner's dissent and stated that if it had been a matter of first impression in the Ninth Circuit, he would have held the trustee here to be a judgment creditor.

It is fundamental that "(w)here the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to rules of statutory interpretation, and the court has no right to look for or impose another meaning." 50 Am. Jur. 205-206. Thus in the *England-Fidelity Tube* line of cases the courts have allowed their unselective anxiety to protect federal revenue sources (see *infra*.) to override the clear meaning of Section 70(c) when read in conjunction with Section 6323(a) of the Internal Revenue Code.

2. *These holdings undercut the consistent pattern of the Bankruptcy Act and the clearly expressed Congressional intent behind Section 70(c).*

The decision of this Court upon which the circuit courts relied in reaching their decisions in *Fidelity Tube* and *England*, *supra*, was *United States v. Gilbert Associates*, 345 U.S. 361, 97 L.Ed. 1071 (1953). That case involved the question of whether a New Hampshire city which had made a tax assessment, declared by state statutory fiat to be in the nature of a judgment, was a judgment creditor *vis à vis* federal tax liens under what is now Section 6323(a) of the Internal Revenue Code of 1954. The Court held:

"In this circumstance, we think Congress used the word 'judgment creditor' in Section [6323(a)]

in the usual conventional sense of a judgment of a court of record, since all states have such courts." *Ibid*, at 364.

However, *Gilbert* clearly did not concern the Bankruptcy Act. In fact, while holding the above language binding, the Court in *Fidelity Tube, supra*, virtually distinguished *Gilbert*:

"The trustee in the instant case argues that the Supreme Court's decision in *Gilbert* was motivated by a desire to procure uniformity among the States in determining questions relating to priority of payment of lien claims and that the Supreme Court ruled as it did because it feared that if each State was left free to designate who was or who was not a 'judgment creditor' under their respective laws there would be lack of uniformity. The trustee contends that under [70(c)] there is no danger of heterogeneity since we are construing federal and not State law and that therefore the *Gilbert* decision is not apposite." *Ibid*, at 781.

Thus this Court now has an opportunity to establish a consistent *federal* pattern, and the concern for State uniformity which underlay the *Gilbert* case is not applicable.

"By its very nature and the method by which it arises, the lien is secret, as to persons dealing with the delinquent taxpayer, and these persons can do nothing to inform themselves of the lien's existence." Note, *The Rights of a Trustee in Bankruptcy as Against a Federal Tax Lien*, 35 Indiana Law Journal 351, 352. The intent of Congress to give the widest possible powers to the trustee in regard to such secret liens under

Section 70(c) is made clear in the legislative history of the section:

"Thus the evil of secret liens has continued. It is this evil and the injustice worked upon creditors who rely upon the debtor's apparent ownership against which the law has set its face. The proposed amendment, whilst correcting the defect named, at the same time carefully guards the rights of all parties. It is evident that in the proposed amendment attempt is made to give effect to two ideas quite distinct: First, that as to the property in the custody of the bankruptcy court the bankruptcy trustee shall be considered to have the same title that a creditor holding an execution or other lien by legal or equitable proceedings levied upon that property would have under state law; and second, that as to property not in the custody of the bankruptcy court the trustee should stand in the position of a judgment creditor holding an execution returned unsatisfied, thus entitling him to proceed precisely as an individual creditor might have done to subject assets. In this way, in effect, proceedings in bankruptcy will give to creditors all the rights creditors under state law might have had had there been no bankruptcy and from which they are debarred by the bankruptcy—certainly a very desirable and eminently fair position to be granted to the trustee." Sen. Rep. No. 691, Senate Judiciary Committee, 61st Cong., 2nd Sess. (1910).

"Traditionally, it is the primary office of the Bankruptcy Act to protect creditors, both secured and unsecured; to marshal the bankrupt's assets; and to distribute them among his creditors equitably and ratably, in accordance with their respective rights and interest.

"It follows from these broad general principles, as well as from the basic provisions of the Bankruptcy Act itself, that—

"(A) a trustee in bankruptcy occupies the position of a 'universal' judgment or lien creditor, with all such a creditor's remedies * * *." H.R. Rep. No. 1293, 71st Cong. 1st Sess. 4 (1949), in connection with the 1950 amendment to Section 70(c).

"(5) * * * Section 2 is the amendment to Section 70(c) of the act above referred to, which has been placed in the bill for the protection of trustees in bankruptcy as correlative to the amendment to Section 60, and also to simplify, and to some extent expand, the general expression of the rights of trustees in bankruptcy." *Ibid*, "Committee Amendment."

Thus it is equally clear that Congress has attempted to expand rather than diminish this power:

"The act was intended to set up a particular scheme of distribution not to be varied by exceptions found outside the act, since to do so would interfere with a well ordered and efficient working act. * * * The Bankruptcy Act has its own schedule of priorities intended to cover all situations within its terms and jurisdiction." *United States v. Sampsell* (9th C.A., 1946) 153 F.2d 731, 735.

Thus, relying on the inapposite authority of the *Gilbert* case, the circuit courts have countermanded the clear purpose of Congress in Section 70(c) and given an extraordinary protected preference to unrecorded federal tax liens.

3. *The effect of the holdings of the circuit court is to deprive employees of the bankrupt and those who attempt to protect the property of the bankrupt's estate of the priority expressly given them over unrecorded federal tax liens by Section 64(a) of the Bankruptcy Act:*

Considering the growing number of bankruptcies filed in the United States—over 25% more in 1958 than in 1932, at the depth of the Depression, 32 J. Natl. Assn. of Ref. 124 (1958) — and the fact that in only about 15% of those cases have assets remained after outstanding liens were paid, Annual Reports of the Director of the Administrative Office of the United States Courts, 1946-1957, the protective priorities established in the Bankruptcy Act assume particular significance. The main beneficiaries of the priorities established in Section 64(a) of the Act are those who act to preserve and administer the estate, and most classes of wage claimants. If the trustee cannot prevail over the unrecorded federal tax liens, the chance of these protected creditors recovering anything from the estate is greatly lessened.

This point was cogently argued in a note on *Fidelity Tube* appearing in 35 Indiana Law Journal 351 (1960) (footnotes omitted):

“The reason the courts usually give for favoring the government is to protect the government revenues. But this policy of protecting the government revenues has not always been so overriding as to outweigh all the equities on the other side. Both Congress and the Supreme Court have allowed the policy to fall by the wayside in actions brought under the Tort Claims Act. The court has said that

when the government is made to stand the loss, the resulting burden on each taxpayer is relatively slight, but when the entire burden falls on the injured party, it may leave him destitute. As a policy matter, analogous reasoning may be applied in bankruptcy cases, and the courts could allow the trustee his status as a judgment creditor even under Section 6323 of the Code. In addition to being more just and equitable, such a result would probably be more in harmony with the over-all policy of the Code and the Bankruptcy Act. If recording is an effective means for warning other creditors of secret liens, * * * the courts should not allow the government to continue luring other creditors into a trap by adhering to the policy of protecting government revenues when recording machinery has been provided whereby notice of the secret lien can be given to the world. The court should simply interpret the language of both the Bankruptcy Act and the Internal Revenue Code according to their plain meaning and hold the trustee to be a judgment creditor within the meaning of Section 6323. Congress has provided protection for four classes of creditors, but court construction has unduly narrowed these classes. If the government lien is secret, it is secret as to anybody dealing with the bankrupt, and since congress has protected judgment creditors from secret liens, the trustee should be allowed his rights under the Bankruptcy Act in order to better accomplish the bankruptcy policy of equitable distribution. In addition to examining the general policy of the two acts, we must also look at the problem from the point of view of the policy of specific provisions of the Bankruptcy Act. The reason for the Section 64(a) priorities is to encourage efficient adminis-

tration. The *Fidelity Tube* decision does just the opposite.

"Also, the government's favored position can cause considerable hardship to others, *e.g.*, attorneys and employees. Congress has sought to insure active and efficient administration of bankrupt estates by allowing the attorney to collect his fee under the first priority of Section 64(a). But as was shown earlier many cases are no asset cases. The attorney is less likely to put forth his best efforts, if he accepts the case at all, when there are tax liens outstanding. He can usually be confident that the lien will prevail, and his chances of recovery for his services are diminished. The plight of employees of the bankrupt is even sadder than that of attorneys. Generally they will ~~not~~ quit their jobs before bankruptcy because of sociological and economic reasons. Thus they are almost forced to sink or swim with the bankrupt. Congress has recognized this plight by granting them a second priority under Section 64(a). The wage earners' needs are usually much more serious and more immediate than those of the government. The analogy to the Tort Claims case is especially cogent in this area, and the court should give relief by applying the plain meaning rule in interpreting the Bankruptcy Act and the Code."

Thus this Court, which has never squarely held on this point, should take this opportunity to clarify the status of the trustee in bankruptcy as a judgment creditor. The only situation in which the government could possibly suffer loss under such a holding is when it fails to protect itself by using the simple machinery of recording its tax lien.

CONCLUSION

For the reasons stated, it is respectfully suggested that the Court of Appeals erred, that liened tax penalties should be held to come under the ban of Section 57(j) of the Bankruptcy Act, and that the language of Section 70(c) of the Bankruptcy Act should be held to give the trustee the status of a judgment creditor for purposes of Section 6323(a) of the Internal Revenue Code of 1954.

Respectfully submitted,

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APPENDIX**FEDERAL STATUTES INVOLVED****Bankruptcy Act**

Bankruptcy Act § 17; 11 U.S.C. §35: Debts not affected by a discharge:

A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversion; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for

the bankrupt; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment. As amended July 12, 1960, Pub. L. 86—621; § 2, 74 Stat. 409.

Bankruptcy Act §57(j); 11 U.S.C. § 93(j) Proof and allowance of claims:

. . .

Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

. . .

Bankruptcy Act §64(a); 11 U.S.C. § 104(a): Debts which have priority:

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the

bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws. Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow: *Provided, however,* That where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed \$600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the

efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy. As amended July 30, 1956, c. 784, § 1, 70 Stat. 725; July 28, 1959, Pub. L. 86—110, § 3, 73 Stat. 260.

Bankruptcy Act §67(b); 11 U.S.C. 107(b): Liens and fraudulent transfers:

(b) The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivision thereof, created or recognized by the laws of the United State or of any State, may be valid against the trustee, even though arising or perfected while the

debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this title by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

Bankruptcy Act § 70(c); 11 U.S.C. § 110(c): Title to Property:

(3) The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Internal Revenue Code of 1954

Internal Revenue Code of 1954 § 6321; 26 U.S.C. § 6321: Lien for taxes:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property,

whether real or personal, belonging to such person.
Source: Sec. 3670, 1939 Code.

Internal Revenue Code of 1954 §6323(a), (b); 26 U.S.C. §6323(a), (b): Validity against mortgagees, pledgees, purchasers, and judgment creditors:

(a) INVALIDITY OF LIEN WITHOUT NOTICE.—Except as otherwise provided in subsection (c) the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

Source: Sec. 3672(a), 1939 Code.

(1) UNDER STATE OR TERRITORIAL LAWS.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

Source: Sec. 3672(a)(1) (in part), 1939 Code.

(2) WITH CLERK OF DISTRICT COURT.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

Source: Sec. 3672(a)(2) (in part), 1939 Code.

(3) WITH CLERK OF DISTRICT COURT FOR DISTRICT OF COLUMBIA.—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

Source: Sec. 3672(a)(3), 1939 Code.

[Sec. 6323(b)]

(b) FORM OF NOTICE.—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

Source: New.